Peace Hills General Insurance Company
Submission to the Alberta Automobile Rate Board
Review of Profit Level for Automobile Insurance
October 20, 2006

Peace Hills Insurance (‘Company’) is a licensed, general insurance company, which has been insuring Western Canadians since 1982. We are committed to serving the community and we feel this is best met by distributing our product through an Independent Brokerage System. The independent insurance brokers’ primary duty is to their client; they can offer a variety of coverage’s and prices to suit your needs. They will act as the individual’s advocate when dealing with the insurance company and is someone who lives and works in your community. Through these business partners, we offer competitive products to consumers across Alberta.

Peace Hills head office is located in Edmonton, Alberta and we have established branch offices in Calgary (1987) and Vancouver (2000). We have over 130 employees who are committed to serving over 300 independent brokers across British Columbia, Alberta, Saskatchewan, Manitoba, Northwest Territories, Nunavut and Yukon Territory.

Focused on customer needs, we have positioned ourselves to deliver the best value to our customers by being flexible and approachable. We are dedicated to providing our clients with the best customer service available. We are also committed to exceptional claims service. Our Claims Department is dedicated to providing courteous and efficient service for our clients. We strive to be fair, reasonable and flexible.

Our Company was started in 1981 when the Samson Cree Nation acquired the dormant charter of the Edmonton Canadian Insurance Company and set up a new organization that was renamed Peace Hills General Insurance Company. The Company commenced operations in 1982 with three employees writing personal lines business in Alberta. Since that time, the Company has expanded to commercial lines and farm properties and writes business in all jurisdictions west of Ontario. In 2001, the Company acquired a six-storey office building on Jasper Avenue in Edmonton which serves as the northern Alberta branch as well as the corporate head office. Ownership of the Company has remained throughout with the Samson Cree Nation through Samson Management Limited.

The Alberta automobile insurance market generates $2.5 billion in premium and is a robust marketplace with 69 active writers. The top 5 companies write approximately 35% of the premium and the top 10, 48%. This makes Alberta one of the least concentrated and most competitive automobile insurance markets in Canada. Property & Casualty insurance is much less concentrated than the banks or life insurers with more players controlling much smaller market shares.

Peace Hills is the 11th largest writer of automobile insurance in Alberta and one of only two automobile insurance companies with their head office in Alberta. Alberta accounts for 99% of the automobile premium written by our Company and automobile insurance represents 54% of the Company's total writings.

The Alberta automobile insurance market is much more significant market to Peace Hills than to other underwriters. Clearly any changes made to the automobile insurance product and/or the pricing or the underwriting of automobile insurance have a much greater bottom line impact on Peace Hills than other insurers.

We will address the questions outlined in the Review of Profit Level for Automobile Insurance, namely the appropriate target level of ROE, reconciliation between the premium margin and return on equity methods and the impact of the impending changes in insurance financial reporting.

The Samson Cree Nation has many choices for the deployment of their capital and bases their investment decisions primarily on the expected risk-adjusted returns. As such, the management of Peace Hills must be able to demonstrate that they will be able to meet their shareholder's profit expectations on a going-forward basis.

The attached Exhibit 1 outlines the results using the Samson Cree's expectation of a 12.5% - 14% post-tax return on equity and the equivalent premium margin. The assumptions underlying this analysis are:

1. An expense ratio of 30.3%. This is as per the historical experience of the Company. While above the industry average, the Company underwrites more rigourously using expense dollars to lower their loss ratio through superior risk selection.
2. The payment patterns as per the historical experience of the Company (as outlined in the 2005 Appointed Actuary's Report).
3. A corporate tax rate of 32.1%.
4. A risk-free rate of return of 3.9% for the investment income on insurance operations based on an average duration of just less than 3 years and an average of the current Government of Canada 1 – 3 and 3 year bond rates.
5. A return on surplus of 5.9% as per the Company's investment performance in 2005.

6. A premium-to-surplus ratio of 1.75 which is in line with expert testimony presented in a similar set of hearings in New Brunswick.
7. The loss ratio of 66% is based on the 2003 to 2005 on-level trended loss ratio for the Company.

Under this set of assumptions, the Company's post-tax return on equity is 12.8%. The equivalent premium margin calculation is 7.4%.

On Exhibit 2, we have estimated the impact on the results of Peace Hills using a 5% premium margin. Lowering the provision for profit to 5% of premium lowers the average premium that can be charged by the Company increasing the loss ratio. The equivalent loss ratio is 2.6 points higher than under the 12.8% return on equity scenario and the return on equity falls to 9.9%. This is clearly below the post-tax return on equity that the Samson Cree Nation could expect to enjoy should they invest in other financial service industries and draws into question why, over the longer term, they would continue to support this venture.

We can support using a percentage of premium approach as it is:

1. Simpler to use, explain and understand
2. Allows for easy comparison amongst companies regardless of capital/ corporate structure

However, the margin selected must be sufficiently high that it allows shareholders to have a reasonable expectation that, if the company is well managed, the returns will be sufficient so that they will not be compelled to redeploy their capital to an alternate investment.

The impact of the new accounting rules will be to increase the volatility of the both the income statement and the balance sheet. The degree of volatility will depend on what percentage of a company's asset are designated as either available for sale or held for trading relative to the percentage that is designated as held to maturity. This increase in volatility may lead shareholders to change their view as to the risk premium that attaches to the industry in turn leading to higher return on equity expectations. As well, the new accounting rules put a greater emphasis on asset liability matching which will lead more companies to invest the cash flow from underwriting in bonds matching the duration of the liabilities.

In conclusion, Peace Hills can support stating the profit provision as a percentage of premiums so long as the percentage of premium is increased from the current 5% level to 7.5% to 8%. This would allow Peace Hill's shareholders a reasonable expectation that, so long as the business is well-run, they will make an acceptable return on equity. This is slightly above the equivalent values shown on Exhibit 1 in order to take into consideration the increased volatility of returns that will likely occur after the introduction of the new accounting rules in 2007.

Exhibit 1
Profit Provision
Peace Hills General Insurance Company

Assumptions		Discount Factor	Income/ Outgo	
Premium	100	100.8%	Premium	99.2
Loss and LAE	66.0%	93.2%	Loss+LAE -net of investment income	61.5
Expenses	30.3%	100.0%	Expenses	30.3
Combined Ratio	96.3%		Net Operating Income	7.4
Tax Rate	32.1%		Surplus	57
Investment Return - Insurance Operation (b/t)	3.9%		Investment Income -Surplus	3.4
Investment Return - Surplus(b/t)	5.9%			
			Total Income (b/t)	10.8
Premium-to-Surplus	175.0%		Total Income (a/t)	7.3
Premium Delay	0.200			
			Premium Margin	7.4%
			Return On Equity	12.8%

1. Loss ratio - average for Company 2003 - 2005
2. Expense ratio - as per most recent filing
3. Investment return - insurance operations - average of current 1-3 and 3 year Government of Canada bond rates
4. Investment return - surplus - 2005 investment yield for PH
5. Premium is surplus - as per New Brunswick profit hearings

Exhibit 2
Profit Provision
Peace Hills General Insurance Company

Assumptions		Discount Factor	Income/ Outgo	
Premium	100	100.8%	Premium	99.2
Loss and LAE	68.6%	93.2%	Loss+LAE -net of investment income	64.0
Expenses	30.3%	100.0%	Expenses	30.3
Combined Ratio	98.9%		Net Operating Income	5.0
Tax Rate	32.1%		Surplus	57
Investment Return - Insurance Operation (b/t)	3.9%		Investment Income -Surplus	3.4
Investment Return - Surplus(b/t)	5.9%			
			Total Income (b/t)	8.4
Premium-to-Surplus	175.0%		Total Income (a/t)	5.7
Premium Delay	0.200			
			Premium Margin	5.0%
			Return On Equity	9.9%

1. Loss ratio - average for Company 2003 - 2005
2. Expense ratio - as per most recent filing
3. Investment return - insurance operations - average of current 1-3 and 3 year Government of Canada bond rates
4. Investment return - surplus - 2005 investment yield for PH
5. Premium is surplus - as per New Brunswick profit hearings